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Domestic Monetary Policy, Technology,
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Testimony

Thank you, Mr. Chairman, for the opportunity to testify before the Subcommittee on this important subject of capital formation in the energy industry. I have been asked to provide testimony with particular emphasis on the electric power industry in the context of recent developments, including the situation in California and events surrounding the collapse of Enron. I would note for the record that I am testifying today in my personal capacity and my testimony does not necessarily reflect the views of Charles River Associates, Inc. or any of its clients. My testimony reflects my experience as a Managing Director in the Global Energy and Power Group of the Investment Banking Division at Merrill Lynch & Co. My testimony is also informed by my prior service as a Commissioner at the Federal Energy Regulatory Commission (FERC) and as a Committee Counsel in the U.S. House of Representatives and the U.S. Senate.

As a high level, first principle, our national policy objective is to provide the American economy with an assured and adequate supply of energy at reasonable cost through a properly designed balance of (i) enlightened, forward looking and light-handed regulation of monopoly activities and (ii) operation of market forces in workably competitive markets subject to appropriate monitoring and oversight. Legislators, policymakers, and regulators have been confronted with a dizzying array of conflicting signals and market dislocations over the past twelve months as a result of California, the September 11th attacks and now Enron. The capital markets have also been challenged by the fast paced developments regarding the accounting adequacy, credit quality, equity valuations, financial disclosure, and future prospects of U.S. energy companies. Capital formation for much needed investment in the infrastructure of the energy industry could be affected negatively as a result of the pervasive uncertainty and increased risk perceived by investors today. Congress can provide critical leadership in the face of these factors by providing a carefully considered and appropriately measured response to any well-established and systemic

failures of law or regulatory policy affecting capital markets or electric power.

Let's turn briefly to California. The post-mortems on why the California turmoil occurred could fill a multi-volume encyclopedia. But, in general the primary causes are deemed to include:

- Retail rate freeze and absence of demand response under CPUC rules
- Lack of long term contracts and dependence on spot market
- Sharp rise in demand
- Existence of market power and absence of workable competition in certain markets at various times
- Record low hydroelectric production
- Record high forced outages
- Record high delivered gas prices
- Credit quality crisis and uncertainty about credit-worthy counter parties
- Restrictive and inflexible air emission regulation
- Major north-south transmission constraints
- De facto moratorium on power plant construction and transmission expansion
- Federal failure to act in timely manner
- State action to municipalize power purchasing under DWR

We all know the results in terms of the electricity price spikes, the bankruptcies, the consumer rate increases, the impact on the California economy, the fiscal cost to the State of California, the ongoing litigation and retroactive refunds, and the continued legislative debate about an eventual resolution. Regionally, the Pacific Northwest states have also experienced negative impacts on their economies, consumer rates and utility financial situations. The fallout from that experience has had significant impact on retail consumer attitudes, state deregulation

plans, federal legislative initiatives, industry restructuring and electricity market development in the western region and across the country.

Ironically, the electricity markets in California and the western region today have returned to a state of relative stability, but certainly not tranquillity by any means. As demonstrated in a recent FERC analysis, prices at the hubs have converged and average around \$30/mwh, while natural gas prices have fallen back to about \$3.00/mbtu. A combination of very mild weather, more normal hydroelectric reservoir levels, additional new generation capacity, reduced demand and demand elasticity, additional conservation measures, increased transmission capacity, more flexible environmental regulation and FERC price mitigation and more aggressive enforcement, among other factors, have led to a more stable market environment. Of course, the jury is still out on the longer term market forecast and the threat of recurring extreme price volatility or a return to rolling black outs, although analysts are more optimistic today than six months ago.

Other witnesses in this and other Congressional hearings have testified about the increasingly urgent need for investment in the nation's electric transmission infrastructure. Investment by any measure has fallen just as the wholesale electricity market under open access policies has grown dramatically. And, just as the electricity system moves toward Regional Transmission Organizations (RTO's), the stress and strain on the transmission infrastructure is going to increase at an accelerating rate for several reasons.

Electricity demand nationwide has continued to grow and is projected to do so at a steady rate. Construction of new generation plants is underway at a record pace, requiring new interconnections and upgrades and increasing the demand for transmission services. Wholesale electric transactions for existing generation, with associated transmission service requirements, have increased several fold in recent years. Additionally, the system already is experiencing increased congestion with growing costs and fast rising transmission curtailments. And probably

not yet well understood or fully appreciated, the existence of a new RTO and wholesale market structure with a standard design can significantly change the wholesale transaction structures and transmission service requirements to execute newly economic trades. In short, there is a critical need to provide investment to maintain the national grid, which undoubtedly will increase in the aftermath of the September 11th attacks and in the new context of homeland defense.

As a result of those relatively inevitable pressures on the electric transmission system, FERC in Order No. 2000 adopted a flexible approach to financing and structuring RTO's. FERC acted prudently to provide the electric industry with the opportunity to structure RTO's as independent for-profit transmission companies (transcos), as Independent System Operators (ISO's) or as hybrid ISO-transco organizations. Hybrid organizations could include an RTO structured as an ISO with one or more transcos as members, who also may provide various services to the RTO.

FERC also developed a transmission rate-making policy for RTO's which was intended to remove pricing disincentives for transmission owners to join RTO's and to help transmission companies become viable businesses. Under that rubric, FERC endorsed Performance-Based Rate Regulation (PBR) for RTO's to create incentives to make efficient operating and investment decisions, share benefits between customers and the RTO, protect system reliability, and prescribe rewards and penalties in advance based on benchmarks. PBR has been implemented for transmission services in Canada and the United Kingdom, in Federal regulation of telecommunications in the U.S., and by State Public Utility Commissions for retail electric, gas, and telecommunications service.

Consequently, while a novel concept at FERC thus far, the PBR approach is well established in regulatory circles. What is less apparent, however, is that it will take some time to collect the required data for the benchmarks for a new, non-power pool RTO. Nonetheless, the

PBR has substantial financial and regulatory appeal as an alternative to FERC's traditional transmission ratemaking policy.

In addition, FERC decided to consider innovative pricing proposals for RTO's, on a case-by-case basis, in response to its concern about continued under-investment in the transmission grid. The possible innovative pricing proposals include a formula rate of return, levelized rates, accelerated depreciation and incremental pricing for new transmission facilities. FERC also encouraged market approaches to congestion management as early as feasible. An RTO also can propose a rate moratorium for the period through January 1, 2005, and capture cost-saving benefits or increase leverage to increase earnings. Additionally, FERC will consider acquisition adjustments on a case-specific basis where there are measurable benefits to customers.

FERC also recognized that the IRS Code created a substantial disincentive for transmission owners to divest substantially depreciated transmission systems. As a result, passive ownership rules provide specific protections and rights for those owners who transfer control to the RTO (transco). Of course, the House-passed energy legislation would address the problem and mitigate or remove that tax disincentive.

Another disincentive exists in the context of registration requirements under PUHCA with the SEC. The multi-state nature of the larger proposed RTO's could trigger a registration requirement for the owner of a small active ownership interest, with relatively severe limitations and approval requirements for other business and financial activity. Several potential strategic partners and equity financial investors have indicated that they would be unwilling to accept registration as a condition of a strategic partnership or an active equity investment in an RTO. Legislative action by the Congress or administrative action by the SEC may serve to remove this financial disincentive at some point.

Not surprisingly, many possible strategic partners and equity financial investors are themselves directly, or are affiliated with, market participants, as defined by Order No. 2000. As such, those potential investors are limited by the FERC rules to a 5% ownership stake for 5 years, in order to ensure RTO independence, although they could make qualified passive investments. Thus, the market participant limitations do constrain the investment opportunity for many potential (and knowledgeable) investors and limit the universe for marketing transco private equity. But, it does not appear that FERC will amend Order No. 2000 to address this issue.

This overall regulatory flexibility has spawned transco proposals across the country, which could create the proper conditions for the nascent independent transmission industry. Transco's could support further development of the competitive wholesale electricity market by accessing capital markets to secure the much needed financing for sustaining capital expenditures, upgrades and expansion of the transmission infrastructure. As a general financial matter, transcos should become attractive as an equity investment to strategic partners, financial (private equity) investors, and the public market.

Strategic partners will be attracted by the opportunity to manage a significant asset base, share in the value creation potential ("gain sharing"), have specified rights with regards to the assets, and an acceptable projected return on the equity investment. There are indications that there are a number of potential strategic partners, however the probable requirement to register under PUHCA with the SEC remains an impediment today. Financial investors will require a well-defined and meaningful investment as a private placement with a subscription agreement, appropriate limitations on liability, an acceptable return and exit strategy, board representation, and other typical features. There are definitely financial investors interested in the transco

opportunity, provided that the specific transco structure can be formulated to satisfy their individual requirements.

Transcos also may become attractive to the public equity markets in the form of an IPO, a spin-off, or a tracking stock, each of which has differing characteristics and conditions. The IPO alternative probably will require, among other factors, a solid management track record of a couple of years, a good business plan and marketing story, sufficient size for liquidity, adequate projected growth and total return, well developed valuation, reasonable regulatory stability, and of course, a positive stock market environment. As a result, it is not likely that the new transcos under Order No. 2000 will be positioned for an IPO in the first or second year of operations. That factor suggests the importance of a strategic partner and/or financial investors in the initial transco financial plan.

Additionally, transcos should be capable of obtaining strong investment grade credit ratings, which will support financing by access to debt markets. Credit rating agencies have become more experienced with the transco concept and have developed a series of quantitative metrics and qualitative factors to assess the credit quality of a transco. A transco with transmission system assets should be able to achieve a solid investment grade rating with a capital structure having debt in the range of 60% to 65%, under reasonably favorable regulatory treatment.

The electric utility industry has moved with reasonable dispatch to capture the opportunity provided by the FERC regulatory flexibility. For example, the Alliance Companies (eight Midwestern utilities and Dominion Energy), Grid South (three investor-owned utilities serving the bulk of customers in North Carolina and South Carolina), SETrans (Southern Company and public power groups in Georgia, Alabama, and Mississippi with Entergy in Arkansas, Louisiana and Mississippi, Grid Florida (the three investor owned utilities which serve

the majority of customers in the state) and TransConnect (five investor-owned utilities in the Pacific Northwest) have proposed and committed resources in varying degrees to a for-profit Limited Liability Company (LLC) structure for their RTO. Utilities, such as First Energy, Detroit Edison and Consumers Energy, have created independent transmission subsidiaries to facilitate options for their systems. In addition, the American Transmission Company with investor-owned and public-owned transmission systems in Wisconsin already has, and the TRANSLink group, including Northern States Power, Mid-American, Alliant, NPPD and OPPD, is in the process of, forming independent transmission companies in the hybrid structure under the Midwest ISO-proposed RTO. Also, Arizona Public Service, Salt River Project, El Paso Electric, Public Service of New Mexico, Tucson Electric and Texas-New Mexico Power have announced a proposal for a new for-profit transco RTO, WestConnect, for the Pacific southwest region. Each of these initiatives will create the opportunity in one form or another to access capital markets for financing purposes.

Two recent developments highlight the opportunity for for-profit transcos. First, a new consortium, in July 2001, won a structured auction in Alberta and signed an agreement to acquire the TransAlta transmission system which supplies 60% of the Province's transmission requirements. The consortium is 50% owned by SNC-Lavalin, one of the leading engineering and construction firms in the world, 25% owned by the Ontario Teacher's Pension Plan Board, a large institutional investor in Canada (OTPP), 15% owned by Macquarie Financial Group of Australia, and 10% owned by Trans-Elect of the U.S. The consortium paid a premium for the TransAlta assets in a competition which reportedly included several other international strategic and financial investors.

SNC-Lavalin made the investment to capitalize on its international engineering and financing expertise, which when combined with the strengths of the TransAlta team, would

support high quality transmission services and much needed expansion of Alberta's interconnections with surrounding jurisdictions. OTPP concluded that Alberta wanted to make it attractive for investors to expand the electricity system, such that the TransAlta transmission business was a good asset to finance pensions. And, Macquarie also saw the acquisition as a good investment and its first of many infrastructure investments in Canada. While not directly on point in the context of U.S. RTO's, this consortium demonstrates that there are strategic investors, such as SNC-Lavalin, and financial investors, such as OTPP and Macquarie, who are prepared to make financial commitments in the transmission infrastructure under favorable financial conditions.

In August, 2001, eight of the Alliance Companies, announced that they had signed a Letter of Intent (LOI) with National Grid USA, by which National Grid USA would become the Managing Member of the Alliance Transco LLC. The transaction was the subject of definitive documents filed on November 1, 2001, pursuant to a detailed Term Sheet attached to the LOI and to a FERC determination that National Grid USA is qualified to be Managing Member. The eight Alliance Companies and National Grid USA made filings at FERC on August 28 seeking the requisite approvals for the joint Alliance Transco LLC. The Alliance RTO previously had been substantially accepted by FERC under Order No. 2000, but the Commission subsequently directed the Alliance Companies to consider a hybrid arrangement on other policy grounds in December.

Nonetheless, the Alliance-National Grid USA transaction is highly significant and well reflects the potential business, commercial and financial benefits of FERC's regulatory flexibility with regard to RTO structure under Order No. 2000. The strategic partnership would be beneficial to the Alliance Companies, National Grid USA and the customers of the Alliance Transco. National Grid USA's parent company has an excellent track record in the United

Kingdom for managing transmission assets effectively and ensuring reliable delivery of electricity. The deal commits National Grid to making \$1 billion in specified investments in the Alliance RTO in exchange for a seven-year management contract and associated compensation. At the same time, the Alliance Companies are provided with significant incentives to divest their assets in the form of cash and attractive passive investments with financial benefits and assured liquidity in several forms.

For those companies which do not divest immediately, there would be various protections to ensure that National Grid USA as Managing Member fulfills its obligations in its functional control of their systems. Both divesting and non-divesting Alliance Companies would have approval rights over certain National Grid USA actions, while National Grid would have a right of first negotiation on any transmission asset sales by an Alliance Company to another party. In my judgment, the Alliance-National Grid USA deal is an excellent example of the types of commercially-based business and financial transactions which are possible under FERC's order No. 2000 and should be encouraged under enlightened energy policy.

Let's turn now to the wholesale electricity markets of the future. The new FERC majority has demonstrated by actions taken and initiatives proposed and discussed over the past several months that federal regulation would move to establish four or five large RTO's and regional wholesale markets over the next few years. Chairman Wood testified before Congress that such regional RTO's were not only required to support competitive markets, but now were imperative for a reliable national power grid as part of homeland defense. He argued that the cost of planning and executing the necessary level of security and infrastructure protection will be significant and will require expertise which only large region-wide organizations can provide.

A Northeast region could consolidate the existing Mid-Atlantic, New England, and New York ISO's. A Southeast region could include the areas in Grid South, Grid Florida, SETrans

(with the Southern Company and the Entergy service areas), and the TVA and public power territories. A Midwest region could include the Midwest ISO service territory, the Alliance service territory and The Southwest Power Pool. Finally, the Western region could cover the entire Western Interconnect, eventually including California, the Pacific Northwest and the Pacific Southwest.

The blueprint for these regional markets involves taking the RTO concept under Order No. 2000 and recrafting it from a transmission service provider in a large multi-utility service territory into a full-blown region-wide energy market with a nationally standardized market design and structure. FERC will set uniform rules for key market design and structural features, such as congestion management, cost recovery, market monitoring, transmission planning, business and reliability standards, the nature of transmission rights and the minimum forms of electricity products and services.

All of the key market functions and transmission services within a single RTO energy market eventually would be identical as IT systems, processes and procedures are eventually consolidated and integrated across an entire region, as contemplated in the Northeast business plan. There would be strong pressure to move to consolidation as soon as possible on a feature by feature basis to avoid sub-regional balkanization, reliance on internal seams arrangements, undue delay and the potential for stranded costs. In the Eastern Interconnect, there also would be strong pressure to accelerate and expand the ongoing inter-RTO seams negotiations with the end-game objective of eventually achieving a relatively seamless electricity market across the Northeast, Southeast and Midwest regions.

With regard to RTO structure, FERC clearly is reconsidering the inherent flexibility of Order No. 2000 in the context of the role of for-profit transcos and various incentives for their establishment. For-profit transcos under Order No. 2000 are required to meet a series of tests,

including independence of governance from market participants, in order to qualify for RTO status. The Commission appears inclined to the view that certain market-related functions of an RTO should not be provided by a for-profit transco, even if it satisfied the Order No. 2000 independence requirements. The expressed concern is that certain market sensitive functions should not be controlled by a for-profit entity with a fiduciary responsibility to shareholders. Rather, such functions should be under a "public spirited" entity with broader public interest responsibility for proper market operations.

At the same time, there appears to be a disposition to retain some form of a for-profit transco entity as a member of an RTO, which could be responsible for some functions and services. These RTO structural issues have been highlighted in the context of several pending cases in the Northeast, the Southeast and the Midwest. Decisions in those pending cases will establish the guidelines for transcos on a going forward basis.

The FERC road map to achieve the new vision of four regional energy markets under the reconstituted RTO concept is now taking shape. FERC has devoted the last few months to refine the overall vision, the regional RTO blueprint and the standardized features for a uniform national market design and structure. FERC plans to embark promptly on a series of generic rulemakings and case decisions to facilitate, conditionally mandate or require the establishment of the several regional RTO's and a systematic process for moving to operational status. That overall effort could take several years for final completion, but there is a disposition to proceed now with all dispatch and not allow the quest for the perfect to become the enemy of the acceptably good. And, in an effort to respond to sharp criticism and strong concerns from several states, FERC has moved to establish regional councils and provide a more active role in decision making for states. The bottom line is the distinct possibility of four highly integrated regional electricity markets by 2004.

Congressional action on electricity restructuring this year appears uncertain, but legislation in both houses could facilitate the new FERC vision. Pending bills provide various forms of express authority to FERC for uniform standards, jurisdiction over all transmission owners, requirements for open access and RTO participation, reliability responsibility, and conditional eminent domain authority for regional transmission siting. Legislation also includes repeal of PUHCA and amendments to the Internal Revenue Code, which could facilitate participation in RTO's by investors, IOU's, coops and municipal systems. Of course, pending legislation could also be used to constrain or refocus that vision if Congress does act on restructuring. In addition, the Supreme Court recently supported FERC's authority under the Federal Power Act to require jurisdictional electric utilities to provide non-discriminatory access to their transmission services and systems, which may provide additional legal support for Order No. 2000.

Turning now to retail electricity markets, the essential fact is that those retail markets will remain largely under the exclusive authority and control of the several states. In fact, Congress has abandoned any immediate disposition to mandate state-by-state retail competition in any form, in part because of California. And, also in part because of California, the progressive movement towards state retail competition has slowed considerably, if not stalled for now.

California has clearly raised the sensitivity of Governors, state legislators, and PUC regulators to somewhere between scaring them politically and persuading them that all of their worst fears about retail competition were well founded. And, both of those concerns have proven handy for opponents of restructuring. At the same time, the advertised benefits of retail competition-- lower prices and increased reliability-- have not generally been delivered to consumers, because of volatile wholesale markets and supply interruptions in various regions. As the *Wall Street Journal* characterized the situation, many individual consumers and now some

industrial customers have come to a simple conclusion about electricity competition: a big pain for a little gain.

One of the most obvious challenges under most state restructuring plans is that the incumbent utility provides an average cost-based and fixed-price default supply alternative which beats the competition. One federal regulator has bemoaned the existence of such default supply and consumer rate freezes as the Achilles heel of eventual retail competition. And yet, the California experience has made it politically more difficult for states to modify those policies.

Pennsylvania, which has often been trumpeted as the most successful of the state restructuring initiatives, is an excellent case study in that regard.

In April 2000, 35% of all customer load in Pennsylvania was served by alternate suppliers, including a majority of industrial load and almost half of commercial load. As a result of an increase of wholesale energy and capacity prices in late 2000 and early 2001, and in the aftermath of the California turmoil, consumers in all classes dramatically swung back to the incumbent utility. The total load served by alternate suppliers dropped to under 10% last summer, and the number of alternate suppliers have gone from around 30 to under 10 today. Indeed, one Pennsylvania commissioner recently called for the adoption of a combination of price caps and variable rates in place of default supply service in an effort to rekindle retail competition in that state.

More generally, this once was anticipated to be the time frame when at least half the states with about 50% of U.S. population would have retail competitive services. Today, however, only fifteen states have real retail competition including the residential consumer. Seven states have acted to delay or revise their programs, fourteen states are continuing to study the matter, and thirteen states have rejected restructuring and have no pending plans. To be sure, many of those states in the latter categories were states, such as those with low cost supplies, which

already had made decisions prior to the California turmoil. Nonetheless, California has surely hardened the opposition at the state level, as well as making a federal mandate virtually impossible.

Perhaps, the best hope in the near term, for supporters of expanded, and eventually standardized, retail competition across the nation, is the new FERC vision. Large, integrated regional wholesale markets would eventually be in operation with relatively seamless interfaces between the regions. And, a more robust and competitive wholesale market could develop with appropriate market monitoring mechanisms to satisfy some, if not all, state concerns about retail competition. That result could in turn give electricity consumers more confidence that there is an actual gain for the perceived pain of consumer choice in a retail competitive market.

The previous discussion of California, FERC policy, competitive wholesale markets and state retail competition provides a useful framework for considering the impact of the Enron collapse on electricity markets, energy companies and capital formation for the industry.

The most striking aspect of the Enron collapse is that the wholesale electricity markets have continued to function remarkably well. There was considerable concern about potential impacts on the markets when the downward spiral began in early October, after the disclosure in the quarterly report of the large writedown and revised financial statements due to the off-balance sheet trusts. The primary concern was Enron's credit worthiness as the marketmaker on the Enron Online trading platform, which then handled about one quarter of the electricity and natural gas volumes traded nationwide. An additional concern was the potential impact on other market players who were counterparties of Enron in either primary arrangements or in hedging arrangements entered into for purposes of risk management, and who had financial or commodity exposure to any Enron problem as a result.

As the Enron downward spiral accelerated in late October leading eventually to the failed merger with Dynegy and the bankruptcy filing, other trading platforms, such as IPE, and other marketmakers expanded positions to provide liquidity and maintain efficient market operations. As a result, there was no disruption in the bulk power markets. There was no interruption in the physical supply of electricity or natural gas commodity. And, there was no extreme volatility and no significant spike in the prices in any regional market (albeit in the midst of slack demand due to September 11 and a very mild fall and winter). These results have confirmed for many analysts the relative robustness and strength of the wholesale competitive markets and the advisability of the Federal policies which support them.

The most immediately negative impact was on other energy companies with merchant power plant portfolios and energy marketing and trading operations. Many of these companies had once been highly valued by analysts and investors as growth plays with price-earnings ratios in the 20 to 30 range by comparison to the low to mid-teens of other companies in the sector. Mirant, NRG and Reliant had successful IPO's during that time in 2000. However, the events in California, FERC price caps in the West and the threat of refunds, coupled with slackening demand, fears of surplus production from new plants and already softening prices due to the developing recession led to downward pressures on the stocks of those companies. There also were developing concerns by the middle of 2001 that a number of the individual companies were committed to power plant development programs that were destined to become operational in a time of significant surplus capacity leading to a major supply bubble.

September 11th and then Enron placed additional negative pressure on those companies. Enron precipitated a perceptible loss of investor confidence in companies deemed to be potentially similarly situated as a result of a constant drumbeat of disclosures of perceived accounting irregularities and auditing failures. The widespread use of off-balance sheet financial

vehicles exacerbated concerns about the actual amount of debt liability borne by companies, triggers tied to falling stock prices and the accounting practices applied to them. The combination of these and related factors have led to reduced credit ratings, historically low stock prices, and higher costs of capital with increased collateral requirements for debt.

The deemed lower credit quality of the companies has led to rating reductions which have proven to be especially problematic, because of the pervasive use of credit rating triggers in commercial trading agreements and financial lending documents. Such triggers can expose a downgraded company to the risk of a termination of a deal or a requirement for additional collateral, both of which can be problematic for a highly leveraged company. The triggers have served to limit financial flexibility and to magnify the impact of deterioration in credit quality, with further negative impacts.

Many of the affected companies responded rapidly to the developing crisis of confidence, which has served to support continued stability in the markets. Most companies have announced major restructuring plans to improve their liquidity, reduce overall leverage (on and off the balance sheet), and strengthen the balance sheets to maintain or regain investment grade credit quality and obtain greater financial flexibility. The net effect has been a fundamental recapitalization of the competitive sector. The business plans and financing strategies have been substantially revised to accomplish those objectives. The revised plans have included a combination of asset sales (including power plants and natural gas properties), equity issuance, equity infusions from financial and strategic partners, and cancellations and deferrals of new power plants.

These actions have already reduced debt levels and enhanced cash flow and liquidity for improved credit quality for some companies. At the same time, there has been a commensurate downward adjustment in earnings projections for many companies. Analysts see a number of

broader ramifications flowing from these actions. The cancellation and deferrals could mitigate the likely boom and bust cycle that otherwise could result from a surplus capacity supply in the mid-decade time frame. Clearly, there also will be a substantial market for divested assets, which may result in a rationalization of asset valuations and prices. And, the recapitalization plans should significantly improve the credit quality across the industry. To be sure, there are many other companies who have maintained strong balance sheets and solid credit quality throughout the period, who are already well positioned to expand asset portfolios, enhance market positions and increase market share.

The financial community has provided a reasonably positive response to the recap plans with several billion dollars of new equity in the companies and restructuring or refinancing of existing debt (albeit with increased cost and tougher collateral requirements). The crisis in investor confidence has not thus far foreclosed access to needed capital investment, but the capital markets remain problematic in the near term. At the same time, increased disclosure, improved financial reporting and greater transparency should serve over time to restore investor confidence.

The Enron collapse already has added to concerns of state authorities reluctant to embrace retail electric competition. They and the public at large are reacting to the wide spectrum of on-going Enron-related policy reviews. Those include accounting standards (such as mark to market and other derivative/hedging issues); accounting practices (such as treatment of special purpose entities); the relationship between auditing functions and consulting services; pension fund rules for investments in the corporation's own securities; corporate governance and fiduciary responsibilities of senior executive officers and Directors; the potential regulation of energy commodity derivatives by the CFTC; potential electricity market manipulation in Western markets; and possible abrogation of power contracts in the West; among other pending matters. I

would respectfully urge Congress, the Administration, and Federal regulatory agencies to strive to complete the reviews in a timely manner and adopt any needed reforms with carefully considered and measured actions supporting competitive energy markets.

At the end of the day, the energy industry will require greater regulatory certainty in all forms of regulation and an increased measure of stability in order to have assured access to capital investment for the critical national energy infrastructure.

Thank you, Mr. Chairman.